Inside Business

The Hampton Roads Business Journal | Insidebiz.com

APRIL 17, 2020 $1.00

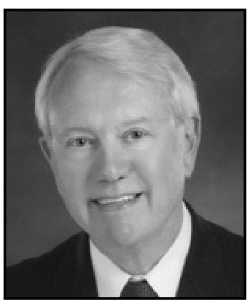
THE ECONOMY

The fiscal quarter that changed America

By Jim Flinchum

In January, the U.S. economy was booming. It was an unstoppable force until it crashed into the immovable object called coronavirus.

The economy came crashing down fast, and that word — fast — is the word that best describes this economic collapse. The stock market reached an all-time record high on Feb. 19. Eight days later, it had dropped 10% into correction territory. Ten days later, stocks had fallen an additional 10% into a bear market. This was warp speed. It was a true "black swan" event — something unexpected that happened suddenly, was surprisingly severe, and looks predictable in hindsight.



Jim Flinchum

The S&P 500 dropped 20% during the first quarter. The information technology and health care sectors performed the best, while the financial and energy sectors performed the worst. Another surprise is that Asia was the best performing region (down only 15%) but Latin America was the worst (down 46%). While bitcoin fluctuated wildly last quarter, gold was steady, up about 7%.

After 113 consecutive months of positive job growth, the March unemployment report showed a loss of 701,000 jobs. It was a meaningless report. Normally, it is our best insight into our economy, but this monthly data was collected in mid-month and is not current enough during this plunge. The initial-unemployment-claims report is published weekly. Over two weeks, 3.3 million Americans filed the first week, followed by an astounding 6.3 million the second week. Both overwhelmed the previous record for filings. Job losses are skyrocketing!

One Fed president predicted unemployment would rise to 30%, which would be worse than the Great Depression at 25% or the Great Recession at 10%. Unemployment might reach Depression highs, but I'm confident it will not remain that high for nearly as long. We will exceed Great Recession levels in April. That's fast! The longer the collapse, the higher the unemployment rate.

Fortunately, the Federal Reserve System learned many lessons during the Great Recession in 2008-2009 and immediately unleashed an alphabet soup of new programs to backstop the financial systems. Plus, Congress required banks to recapitalize in 2010, increasing their ability to absorb losses. I may worry about this sudden biological recession morphing into a mild economic depression, but I don't worry about another financial crisis.

The biggest threat to our financial system is the high-yield market, in particular the junk bonds issued by energy companies. The 66% drop in the price of oil makes it hard to service their bonds. Too many smaller oil companies got caught in the struggle between Russia and Saudi Arabia. We need them to survive, if only to save the high yield bond market.

Congress has limped to the rescue with a $2 trillion dollar "stimulus/rescue" package as a crutch for the falling economy. They need to distribute that money as quickly as the collapse happened, but that may not be possible. When Congress limps back with another package, it will probably be aimed at infrastructure, which we do need, but the funds enter the economy too slowly. Speed matters. Still, it was heartening to see Republicans and Democrats work together.

It is a fair criticism of the massive government response in 2009-2011 that only the large companies benefited, as well as needlessly enriching the rich. To correct this, the new rescue bill allocates almost $350 billion to the Small Business Administration to make forgivable loans — fast — to small businesses, with a goal of keeping employees on the company payroll. Unfortunately, the SBA has not received any loan guidelines to follow nor any relief from the paper-intensive rules. This is a great idea in a normal recession but may be too slow during a sudden collapse.

Washington economists and Wall Street strategists were besieged with questions about "how bad will it be" and "how long will it last." Because this collapse was not caused by economic factors nor financial factors, the pundit should respond "don't ask me, ask an epidemiologist!" This black swan recession was due to biological factors.

It is important to remember that we have already survived epidemics from AIDS, H1N1, SARS and Ebola. The last pandemic was the Spanish flu in 1918, when an incredible 50 million people died worldwide, including 500,000 in the U.S. (Note: The much worse 1918 pandemic did not cause the Great Depression in 1929.)

...continued

PREDICTIONS

The economy will recover — how long will depend on the government. I expect big decreases in gross domestic product during the second and third quarter before leveling out in the fourth. One major investment house predicts GDP will decrease 34%, which would be staggering. We do expect positive GDP growth by early next year. The stock market will recover — timing will depend on the pandemic. Once the rate of new infections slows, the market should start recovering.

Our recovery will not be V-shaped, with a sharp fall followed by a quick recovery. Nor will it be a L-shaped, with a sharp fall and no recovery. It may be a U-shaped recovery, with a sharp fall, followed by a period of reconsolidation before a sharp recovery. Or, it may be a W-shaped recovery, with a sharp fall, a sharp recovery and then a repeat of both.

I suspect our recovery will look like a checkmark, with a sharp drop and a moderate but continuous recovery. Before recovery starts, there will be substantial realignment of resources and the supply chain, based on who survived and who can still produce.

Long term, we have learned that businesses need less office space and that online retailers have a bigger advantage than earlier realized. Commercial real estate agents will adjust — they always have.

The stay-at-home lockdown will have the greatest long-term impact on today's teenagers. It is more than mere "cabin fever." It is the harsh realization that there are tiny invisible evil things out there to ruin your life. If you can, spend some time sharing your emotions and your experience with them during this stressful time.

Lastly, health care workers will finally get the respect that firemen and first responders received after the 9/11 tragedy. But, don't forget the grocery workers and the truck drivers. We need them all.

Jim Flinchum *is a financial planner and investment strategist with Bay Capital Advisors in Virginia Beach, and a member of the National Association of Business Economics. Contact him at www.baycapitaladvice.com.*